

George L. Stern

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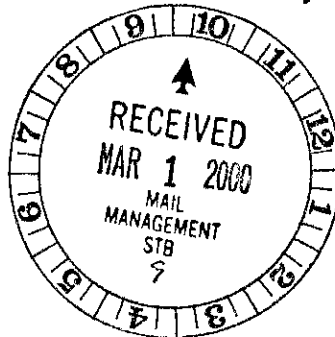
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February 29, 2000

Mr. Vernon A. Williams
Secretary
Surface Transportation Board
Office of the Secretary
Case Control Unit
Attention: STB Ex Parte No. 582
1925 K Street, N.W.
Washington, D.C. 20423-0001



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Office of the Secretary

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Dear Mr. Williams,

In accordance with the February 16, 2000 decision of the Surface Transportation Board in Ex Parte No. 582, I have noticed my appearance for the hearing to be convened in Washington on March 7. Most of my opinions are more appropriate for consideration in the BNSF/CN control proceeding. Nonetheless, I do have some views regarding the broader matters that you are considering in Ex Parte No. 582. In accordance with your February 16 decision, this letter provides a summary of my views regarding those broad policy matters.

I. Qualifications

Prior to becoming a consultant, and for nearly 40 years, I held various positions in the railroad industry including: President and Chief Operating Officer of the New York & Atlantic Railway; President and Chief Executive Officer of the Chicago & Illinois Midland Railway; Assistant Vice President - Operations of the Grand Trunk Western Railroad; Vice President - Operations of the Detroit Toledo & Ironton Railroad; Assistant Vice President - Intermodal and Automotive of the Illinois Central Gulf Railroad; Manager - Transportation Planning of the C&O-B&O Railroad; Manager of Distribution, Plastics Division, Vistron Corporation, a division of Standard Oil (Ohio); and Transportation Economist, Litton Great Lakes, a Division of Litton Industries.

I am a graduate of Columbia School of Engineering and the Harvard Graduate School of Business Administration. I am a registered Professional Engineer and a Certified Member of the American Society of Transportation & Logistics.

As a transportation consultant, I have conducted nearly two dozen due diligence reviews of railroad operations for potential short line acquisitions, including one proposal to purchase the line of the former Canadian Southern between Detroit and Buffalo. On behalf of the Detroit/Wayne County Port Authority, I prepared a study of the need for and potential use of a

central Intermodal and Container facility in the City of Detroit. On behalf of the State of Ohio, I reviewed the implications of the partitioning of Conrail on the future of the Neomodal Intermodal site in Stark County, Ohio. For a major Great Lakes ship owner and operator, I studied the current and future potential for the consumption of Powder River Basin coal east of the Mississippi, with particular emphasis on Eastern Canada, New England and the states bordering the Great Lakes. For the Grand Trunk Western Railroad, I participated in a study of rail transportation routes from Chicago and Winnipeg to New England and Mid Atlantic states. For a major manufacturer of automobiles and trucks, I investigated alternate rail routes to avoid congested terminals and rail lines resulting from the partition of Conrail.

I have appeared, as an expert witness, before the Surface Transportation Board on behalf of the State of Ohio in STB Finance Docket No. 33388, *CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company—Control and Operating Leases/Agreements—Conrail, Inc. and Consolidated Rail Corporation*; on behalf of Chemical Lime Company in STB Docket No. AB-441 (Sub-No.2x), *SWKR Operating Co.—Abandonment Exemption—in Coshise County, AZ*; on behalf of Central Power and Light Company in STB Finance Docket No. 32760 (Sub-No.21), *UP/SP Merger—Oversight Proceeding*; and, most recently, on behalf of FMC Corporation in STB Docket NOR-42022, *FMC Corporation and FMC Wyoming v. Union Pacific Railroad Company*.

I have studied and written widely on Railroad policy issues. I wrote an article for the Transportation Research Forum, which I later presented before the Pan American Railway Congress on the history, since 1851, of the encouragement and protection of railroad investment by the United States Congress. Four years later, I again appeared before the Pan American Railway Congress to explain the advantages and inevitability of Deregulation of the United States railroad industry. Nearly fifteen years ago, I wrote an article in the Harvard Business Review advocating freedom for common carriers to contract with shippers for transportation.

II. Views Regarding The Broad Matters Being Considered In Ex Parte No. 582

Your January 24 decision in Ex Parte No. 582 posed several policy-oriented questions regarding future major rail consolidations in North America. Below, I summarize my views on six of them.

1. Further Consolidations: You have asked whether the proposed merger of Burlington Northern Santa Fe and Canadian National (BNSF/CN) would likely lead to significant additional consolidation in the railroad industry. I see no reason for it to do so.

The BNSF/CN combination appears to have two primary competitive impacts. First, it will definitely increase competition on North-South routes from Canada to Mexico. In that respect, it follows the same NAFTA strategy that motivated last year's CN/IC transaction. Second, it is also likely to increase the efficiency of the services of the combined BNSF and CN,

and thus increase competition along all points served by those carriers. It is hard to see any impetus for East-West mergers from either of these competitive benefits.

On the other hand, some might say that these competitive effects make a combination such as UP/CP more likely. My experience is that this is not necessarily so. Past predictions have often proven wrong. Often, the “next step” to occur in rail consolidations is a transaction that was not expected, like BNSF/CN.

2. Service: The Board has asked about the service difficulties that future rail consolidations might bring to shippers. Some past transactions may have been followed by such difficulties, but others have not. Nor is it likely that all future transactions will encounter service difficulties akin to those on UP following its SP combination or on CSX and NS following their division of Conrail.

It is therefore my view that the Board should not predicate its policy on the mistaken view that major rail transactions necessarily cause service disruptions. Rather, the Board must make a reasoned judgment as to whether any particular transaction is likely to occasion service disruptions and, if so, to craft appropriate conditions.

I do not believe that the BNSF/CN transaction presents the risk of transaction-related service difficulties. As I mentioned at the outset, however, I believe that the specifics of this transaction are better addressed on the merits in the evidentiary hearing that the Board will be holding with respect to the control application. In my view, the Board should follow its practice of doing so promptly.

3. Financial and Capacity Impacts: The Board has asked how future rail consolidations will impact the rail industry’s financial condition and need to have infrastructure, capacity and configuration to meet expected capacity demands. It is my view that major rail consolidations help create and maintain financially healthy railroads, and they are therefore necessary towards meeting demand for future freight transportation service. Consolidations can alleviate existing interchange bottlenecks and service shortcomings, and they can also make railroads better able to respond to a growing demand for rail transportation.

Indeed, effective capacity has been improved even in those recent transactions that have been followed by service difficulties. As the STB is well aware, the Union Pacific added track capacity to its main line both west and east of North Platte, and is now doing so on the line north of Kansas City. Likewise, CSX has added track capacity east of Chicago, and the Norfolk Southern expanded its terminal in Buffalo. Thus, although these carriers have experienced service difficulties of a transitory nature, they have created capacity benefits that will last for decades.

4. Timing: The Board has asked about the timing of the BNSF/CN combination, questioning in particular whether the industry might better channel its present efforts towards

improving customer service. Although this is a matter to be addressed in the control proceeding, it is my view that the BNSF/CN combination *will* improve customer service. To me, that demonstrates that its timing is appropriate. I can see no reason to delay these customer service benefits, particularly when I see no likelihood of customer service difficulties.

The BNSF/CN combination will also increase competition. This, too, comes at an appropriate time. In my view, increased competition will create added incentives for other railroads to resolve the service difficulties they are experiencing following their consolidations.

5. North American Structure: You also have asked about the possibility that there could be further consolidation resulting in only two major North American railroads. Each major rail transaction of the past decade has been accompanied by such speculation, but to my recollection, no one has ever provided a sufficient justification concerning the synergies to be obtained in an East-West combination from which one could make a reliable prediction.

6. Downstream Effects: I have had extensive experience as both a practical railroader and an analyst. I think that this Board's analysis of "downstream" effects must distinguish between real, readily ascertainable effects and speculative hypothetical effects. Any good planner can speculate, build models and otherwise "forecast" the future. But in rail consolidation matters, very little can be deemed realistic until someone has committed to make a real investment and negotiated an agreement with another railroad. Thus, I would advise the Board to ignore predictions of "inevitable" transactions by other railroads until they actually happen.

Very truly yours,


George L. Stern

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